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Section 363 Offers Big Advantages

Even though the economy in general appears to be improving, the bankruptcy courts continue to see new cases. This is true of healthcare companies as well as enterprises from other industries.

When a healthcare company gets into trouble, usually defined as having a lack of cash available to meet its current obligations, there are several courses open to management to cure its problems.

Raising equity, borrowing more or renegotiating existing debt, shedding assets to generate cash, or negotiating with creditors for extended terms are but a few of the options open to business owners.

What happens, though, if all of these have been exhausted?

Increasingly, companies are finding the Section 363 Sale of Assets under Chapter 11 of the U.S. Bankruptcy Code to be an attractive option for both sellers and buyers of assets.

Chapter 11, of course, is the bankruptcy option elected by most businesses when conditions require extreme actions. Within Chapter 11, however, management must make key decisions as to how best to emerge if emergence at all is a feasible option.

Once in Chapter 11, one option is to present the Court with a Plan of Reorganization. For a variety of reasons, it may be difficult or impossible to get approval of all stakeholders in the proposed Plan. At this point, a Section 363 sale of all or a portion of the entity's assets becomes an attractive option for all parties.

Under Section 363, a prospective buyer and a Chapter 11 debtor or seller will present a fully negotiated asset purchase agreement for approval by the Court. This may have been arranged even before bankruptcy is filed or it may be negotiated after

other options are exhausted once in reorganization.

If approved, this agreement provides that the sale is free and clear of all prior liens and claims, including claims that may remain unpaid after the sale is completed. The benefit to the buyer is the ability to obtain clean assets and to avoid the inevitable battle between competing classes of creditors that often occurs when Plans of Reorganization not involving asset sales are filed.

Investment bankers become involved because the Courts will typically require a competitive bidding process to ensure that the process results in the highest possible return to creditors.

The process begins with the Banker identifying a "Stalking Horse" bidder with whom a fully negotiated Purchase Agreement is arranged and then filed with the Court. There are several advantages to being a Stalking Horse if you are interested in acquiring assets through bankruptcy. These advantages outweigh the fact that your bid will be widely published and the Banker will actively seek to identify higher bidders.

The advantages include the provision within the Purchase Agreement that a breakup fee will be paid to the Stalking Horse as compensation for its costs and lost opportunity if a higher bidder is ultimately accepted. While there are guidelines for the amount of this fee as a percentage of the total assets to be sold, the fee can often be quite lucrative and certainly sufficient incentive for a bidder to be the Stalking Horse.

Other advantages for the Stalking Horse include: restriction of the time period in which competing bids can be made (the shorter the bidding time, the less likely a higher bidder can be identified); negotiation of reps and warranties which must be accepted as is by other bidders; knowing that the bidding increment must be at least high enough to offset the breakup fee and thus raising the price to other bidders; restricting bids to cash with no financing contingencies, thus eliminating many bidders; and restricting the asset package to be purchased, reducing the options avail-

able to other bidders.

Once a Stalking Horse bid is accepted by the Court, a process ensues in which an organized effort is made to identify potential buyers willing to bid higher. This may be done over a period of time but is usually done on a given day in a virtual auction format. The Banker is charged with the responsibility of ensuring that as many potential buyers as possible are contacted and identified in the relatively brief period allowed by the Court to see competing bids.

The definition of "highest and best" bid is that bid which results in the highest possible return to creditors. This usually means cash, but not always. Two common components of highest and best are certainty and speed of closing. Others may include willingness to assume certain pre-petition creditor obligations, although this is tricky because other creditors will undoubtedly object if they believe they are being treated disproportionately.

Once approved by the Court and finalized, a Section 363 asset sale has certain key advantages to purchasers. These include sales free and clear of previous (and all) liens; assignment of certain valuable leases and contracts and rejection of others; and finality. As with most legal matters, there are exceptions to each of these and complications that can void each or all. But, as a general rule, buyers purchasing assets through a Section 363 process can be assured of the cleansing effect of the process on the assets purchased.

At the same time, sellers of those assets — and particularly management teams seeking to preserve their roles and upside opportunities — often find Section 363 asset sales to the right party to be a fast, efficient, and effective means of starting life anew with a clean slate.

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